Engineers Australia
Public Affairs Note

ENGINEERS AUSTRALIA

Budget 2017: Infrastructure update

Key Points

The 2017 Commonwealth budget for infrastructure is less exciting for its headline figures than it is for a shift towards more sensible project funding and use of infrastructure plans.

In every Commonwealth Budget in recent memory, Governments trumpet long lists of infrastructure projects that cover the length and breadth of Australia. Despite this alleged saturation coverage, Engineers Australia's analyses of engineering construction of infrastructure on the ground has shown steady deterioration since at least 2012. This trend is probably older, having been hidden by the extraordinary construction associated by the resources boom.

When we view the 2017 infrastructure allocations through the prism we used to examine last year's allocations we see a continuation of the status quo. Long lists of projects—some large and some small—in programs that are not always about new physical asset construction but blur the lines between capital and recurrent expenditure.

However, this year there is a critical difference. Building on the national infrastructure audit by Infrastructure Australia and the national priority list it identified, the Commonwealth has cast aside the political myths associated with the "debt and deficit" mantra in favour of the well-known economic distinction between recurrent and capital expenditure.

In the Budget there is a pronounced shift towards funding infrastructure using loans and equity finance. The way forward was demonstrated by the Rudd Government's approach to funding the NBN and the Turnbull Government has now grasped this methodology, expanded and formalised it and is running with it.

There are still potential hazards, the most notable of which is to believe that Australia's infrastructure deficit has been solved. An imaginative start has been made and persistent grind over many years is now necessary to fully deal with our infrastructure deficit. Along the way we should not waiver from the importance of comprehensive project evaluation including benefit cost analyses.

The political landscape is littered with dud projects or projects that cost far too much. The infrastructure system is now rebelling against this and Engineers Australia commends the efforts of Infrastructure Australia to right the system. Engineers Australia is greatly encouraged by the changes announced in the Budget and strongly urges all involved to continue comprehensive project assessment because this is critical to make the new funding approach work.

1. The Headlines

The annual Commonwealth Budget is a complex structure and that is illustrated perfectly this year, especially in the headlines for the National Infrastructure Plan. The key ones are:

- $70 billion committed to transport infrastructure across Australia using a combination of grants, funding, loans and equity investments. This figure covers the period 2013-14 to 2020-21, in other words starting from the first budget of the current Liberal-National Government.
- Another budget priority set out in Budget Paper No 1 is establishing a 10-year allocation for funding road and rail investments that will deliver $75 billion in infrastructure funding and financing from 2017-18 (that is, the current budget) to 2026-27.

What complicates analyses of infrastructure in the Budget is that all Governments, irrespective of political colour, put forward extensive lists of infrastructure projects that "get a guernsey" with the objective of demonstrating to local constituents what is happening in their area. Unfortunately, projects are for varying durations, often have been underway for some time already, sometimes cover maintenance rather than new investment and sometimes re-announce existing projects.

In this Note reconciliation of what the Government has proposed at project level cannot be done for these reasons. What we can do is review key structural elements of the infrastructure budget to establish what has changed since last year.

Historically, the Commonwealth has provided specific purposes grants to the states and territories to fund infrastructure projects. The effect of this mechanism has been to create a debt in the Commonwealth Budget while creating assets in state and territory budgets. As we have done in previous years, Section 2 reviews Commonwealth specific purpose grants to the states and territories for the current budget year and for several out years.

Last year and in several earlier years, our comparison covered five years: the budget year and four out years. However, this year information was provided for only three out years. Accordingly, we have adjusted our comparison to suit[1].

However, relying on specific purposes statistics this year will give a false picture. The Government has announced an important strategic change to how it intends to approach infrastructure investment in future. We outline this approach and comment on it in Section 3.

2. Specific Purposes Grants to States and Territories

Specific purpose grants to the states and territories have been the mainstay of Commonwealth assistance for infrastructure development by these jurisdictions. These grants are, of course, supplemented by jurisdictions' own resources derived from their tax bases and from our sources like the sale of government owned assets, including infrastructure. Information on specific purposes grants to the states and territories is usually available for the forthcoming budget year and several out years. We noted above that, this year, four years of information is available compared to five in earlier years.

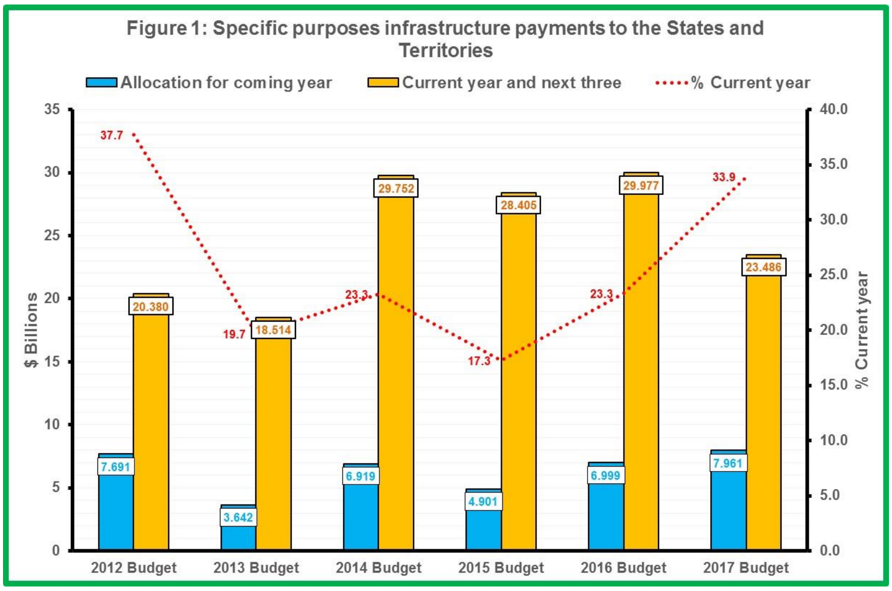
Figure 1 compares specific purposes grants for the last two budgets of the former Labor Government and the four budgets brought down by the current Liberal/National Government.

[1] If comparing this Note to last year's, please note that the figures presented here exclude the previously used "fifth" year.

In the 2016 Budget, $6.999 billion was allocated to the states and territories in the form of specific purposes grants for infrastructure. In current Budget Papers, we observe that $7.592 billion was actually allocated and the difference is related to decisions taken after the 2016 Budget was brought down and prior to the process for the 2017 Budget commenced. For example, an extra $226 million was provided to Western Australia to maintain its GST relativity at the level of the previous year and included in an announced infrastructure package for that State in the 2017 Budget.

What this means is that the specific purposes allocation in the 2017 Budget, $7.961 billion, should be compared to the actual allocation in 2016-17 of $7.592 billion. This was an increase of 4.9 per cent, but bear in mind that the statistics in Figure 1 are in current values and do not take into account the effects of inflation which, while low, is still a factor.

The yellow bars in Figure 1 illustrate the total allocations planned for the current Budget year and for three out years. In each of the last four budgets these totals are higher than in the last two Labor budgets. This is an unfair comparison because infrastructure allocations were higher in earlier Labour Budgets but time and space impedes a fuller comparison. Compared to last year, the total allocation for the four years of specific purpose grants is 21.6 per cent lower.



As Figure 2 shows, out year estimates for the current Budget follows the familiar pattern of becoming smaller the further away one gets from the current Budget year.

Another point to note is that the cash allocation in the 2017 Budget is a good deal lower than the estimate for 2017-18 included in the 2016 Budget. In the absence of the change in Budget strategy by the Government these points would be matters for serious concern. However, unlike previous years, specific purpose grants now need to be considered in a broader approach to capital investment which we look at in Section 3.

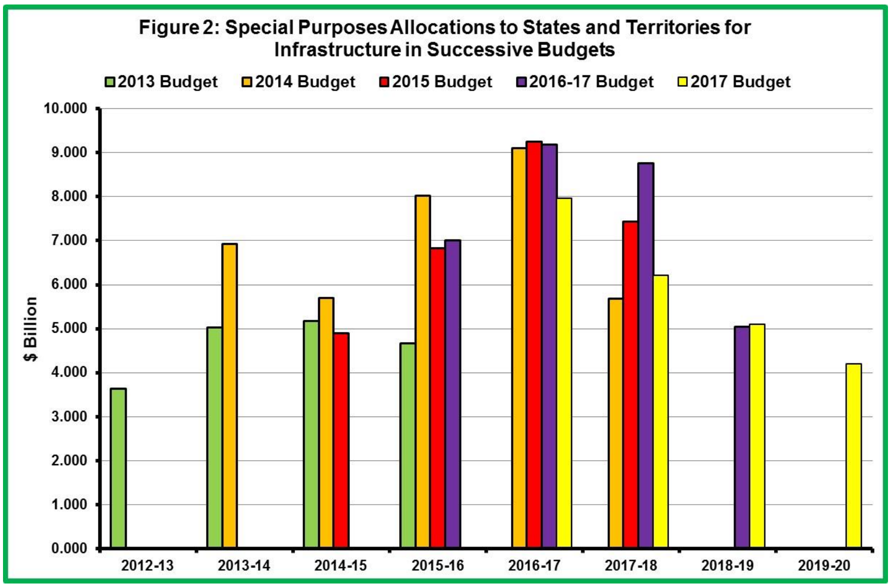


Figure 2: Special Purposes Allocations to States and Territories for Infrastructure in Successive Budgets

Details of the programs that make up the totals of specific purposes grants are shown in Table 1. These figures are further divided into allocations by states and territories. We do not cover that dissection here but any reader who is interested will find the information contained in pages 47 to 53 in Budget Paper 2 (www.budget.gov.au).

Table 1: Details of specific purposes grants to States and Territories for infrastructure ($M)

Purpose	2016-17	2017-18	2018-19	2019-20	2020-21
Infrastructure Investment Program					
Black spots projects	25.0	85.0	85.0	85.0	60.0
Bridges renewal program	64.3	90.0	85.0	85.0	60.0
Developing Northern Australia	13.7	233.9	262.5	189.9	..
Heavy vehicle safety & productivity	50.2	60.0	60.0	70.0	40.0
National rail program	..	..	..	200.0	400.0
Improving national rail network	207.9	438.1	415.6	345.0	658.0
Improving national road network	4231.5	4158.4	3916.1	3458.4	2083.5
Roads to recovery	815.1	699.6	364.5	399.7	399.7
Infrastructure growth package					
Asset recycling initiative	1018.9	898.3	369.4	..	..
New investments	515.5	473.8	74.6	6.7	..
Western Sydney Infrastructure Plan	278.8	725.0	488.1	190.0	430.0
Asset recycling- energy initiative	..	18.3	18.3	..	..
Infrastructure projects in WA	226.0	..	..	..	..
Interstate road transport	71.0	71.0	71.0	71.0	71.0
MDB regional economic diversification	22.7	..	..	..	..
Supporting drought affect communities	21.3	5.0	5.0	..	..
WiFi and mobile coverage on trains	..	5.0	5.0	2.0	..
TOTAL	7561.8	7961.4	6220.1	5102.7	4202.1

The heavy emphasis on roads is clearly evident in Table 1. In 2017-18, specific purposes grants for road construction accounts for about 52 per cent of the allocation, not including the array of other smaller programs related to roads like the "black spots" program. Also included in Table 1 are programs like the bridges renewal program which reflects the neglect of on-going maintenance and replacement planning on which Engineers Australia has consistently commented.

Taken at face value, the information discussed in this Section suggests a status quo approach to infrastructure development. When one takes into account economic expansion over time and inflation, the picture is worse, representing a deterioration in infrastructure allocations by the Commonwealth. However, conspicuously absent from Table 1 are references to the development of the inland railway, Badgery's Creek airport and Snowy Hydro. These projects are not to be pursued in the traditional way and are part of a refreshed approach to infrastructure investment.

3. The Commonwealth's Capital Account

For too long, budget politics have been based on myths about the use of debt finance. "Debt and deficits" has been the most recent catch cry but there have also been other forms from both sides of politics. The approach put forward in the 2017 Budget puts this nonsense to the sword by recognising one of the oldest principles of economics: using debt to finance income-earning assets is a good thing to do.

The Charter of Budget Honesty established by the Howard Government led to the adoption of the concept of underlying cash balance as the overarching Budget bottom line. The underlying cash balance records the cash requirements of all Government activities and its use meant that the politics of deficits precluded the use of debt finance for infrastructure investment. Any form of debt, including infrastructure, contributed to deficits in underlying cash balances and therefore almost by definition were treated as bad policy.

The first break with this approach was by the Rudd Government which financed the NBN development "off the books" so that the loans and investment put forward by the Commonwealth did not add to the Budget bottom line. The justification for this departure was that, upon completion, the Government's intention was to sell the NBN to the private sector in order to recoup its investment.

There is nothing particularly new in this approach which is recognised in the Charter of Budget Honesty through the concept of the net operating balance which is an accrual measure of revenue less expenses (depreciation of existing capital assets is included as an expense) and does not include new capital investment like infrastructure. What the Government has done is to more explicitly recognise this distinction by differentiating between its recurrent account and its capital account.

In 2017-18, the Commonwealth's capital spending will total $50.6 million which is funded and financed in three different ways:

- The Commonwealth spends directly to acquire physical assets, for example defence equipment. In 2017-18 this form of capital spending will be $13.5 billion or 3.5 per cent of total government spending.
- The Commonwealth provides grants to others to acquire capital assets such as the specific purposes grants. This form of capital investment detracts from the underlying cash balance and the net operating balance. In 2017-18, this form of capital spending will be $14.2 billion or 3.4 per cent of Commonwealth spending.
- The Commonwealth directly spends to acquire financial assets in the form of loans or equity contributions to third parties. This appears in the Budget as an investment in financial assets and does not impact on the underlying cash balance or net operating balance because it creates a financial asset on the Commonwealth's balance sheet. In 2017-18, this form of capital spending will be $22.9 billion or 5.5 per cent of Commonwealth spending.

The third form of capital spending was the mechanism used to fund the NBN. It will now be used for an enlarged list of projects which include:

- An equity investment of $8.4 billion in the Australian Rail Track Corporation to deliver the inland rail project.
- An equity investment of up to $5.3 billion in the Western Sydney Airport Corporation to develop the second Sydney airport.
- The expansion of the Snowy Hydro scheme.

Following a British example, the Government will establish and fund a new agency, the Infrastructure and Projects Financing Agency to assist the identification, development and assessment of innovative financing options for investment in major infrastructure projects to be located in the Department of Prime Minister and Cabinet.

The development of this approach to financing large infrastructure projects is critically important. Many commentators have pointed to the large scale availability of private sector funds for infrastructure but have lamented the impediments to utilise this potential. As the comments in the next Section show, though numerically few projects are involved at this stage, they are very large and complex. Over time we should expect the number of projects to increase and quite possibly see a reduction in the number and value of projects funded through specific purpose grants.

4. Comments on the Big Ticket Items

This Section briefly reviews and comments on several of the largest new infrastructure developments announced in the Budget.

4.1 Inland Railway

The basis for this project is the expected increase in freight transport between Melbourne and Brisbane, and points in-between, which is expected to grow from 4.9 million tonnes in 2016 to 13 million tonnes in 2050. The line would be approximately 1,700 kilometres in length of which 40 per cent would be constructed as new railway or converted from narrow gauge to dual gauge. The project envisages 1,800 metre single stacked trains from the commencement of operations, increasing to double stacked trains within a few years and to 3,600 metre double stacked trains as capacity requirements grow.

The capital cost on P50 basis is estimated to be $9.89 billion. The project has been comprehensively assessed by Infrastructure Australia, including benefit cost analysis and sensitivity analyses of benefit cost against identified risk factors. The project has been identified as a national priority in Infrastructure Australia's priority list.

Engineers Australia believes the approach to this project ticks all the boxes. Comprehensive planning, comprehensive project assessment by Infrastructure Australia, inclusion in Infrastructure Australia's national priority list and political support. The funding mechanism proposed underpins the confidence in commercial viability. Engineers Australia supports this initiative.

4.2 Western Sydney Airport

A second Sydney airport has been under discussion for over 40 years but the decision to proceed has now been taken, initially by Prime Minister Abbott but operationalised by Prime Minister Turnbull. The project is envisaged in stages. Stage 1 to be completed before 2026 comprises a single 3,700 metre runway with a parallel taxiway and associated terminal and support facilities. A second parallel runway is envisaged for the future.

The fact that the owners of Sydney airport rejected their first option to build the second airport underscores the complexity of the task. Stage 1 is expected to cost $5 billion (at P50) with further works required to expand the airport.

The project is part of Infrastructure Australia's national priority list and has been comprehensively assessed by that organisation, including benefit cost analyses and associated sensitivity analyses on identified risk factors.

Engineers Australia believes this project also ticks all the relevant policy boxes and supports the decision to proceed with it.

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